Private M&A Into Canada:
What US Buyers Should Know

Overview

Canadian private M&A and business practice are very similar to the US. As such, US buyers can generally expect fewer surprises heading north than into other foreign jurisdictions. For these and other reasons, Canada is one of the most popular destinations for US outbound M&A, both in deal volume and deal value.

We've prepared this overview of private M&A into Canada to facilitate cross-border investment. Given the high-level similarities in law and market practice between our countries, we've focused on major differences and the most relevant considerations for *US buyers* coming *into Canada*.

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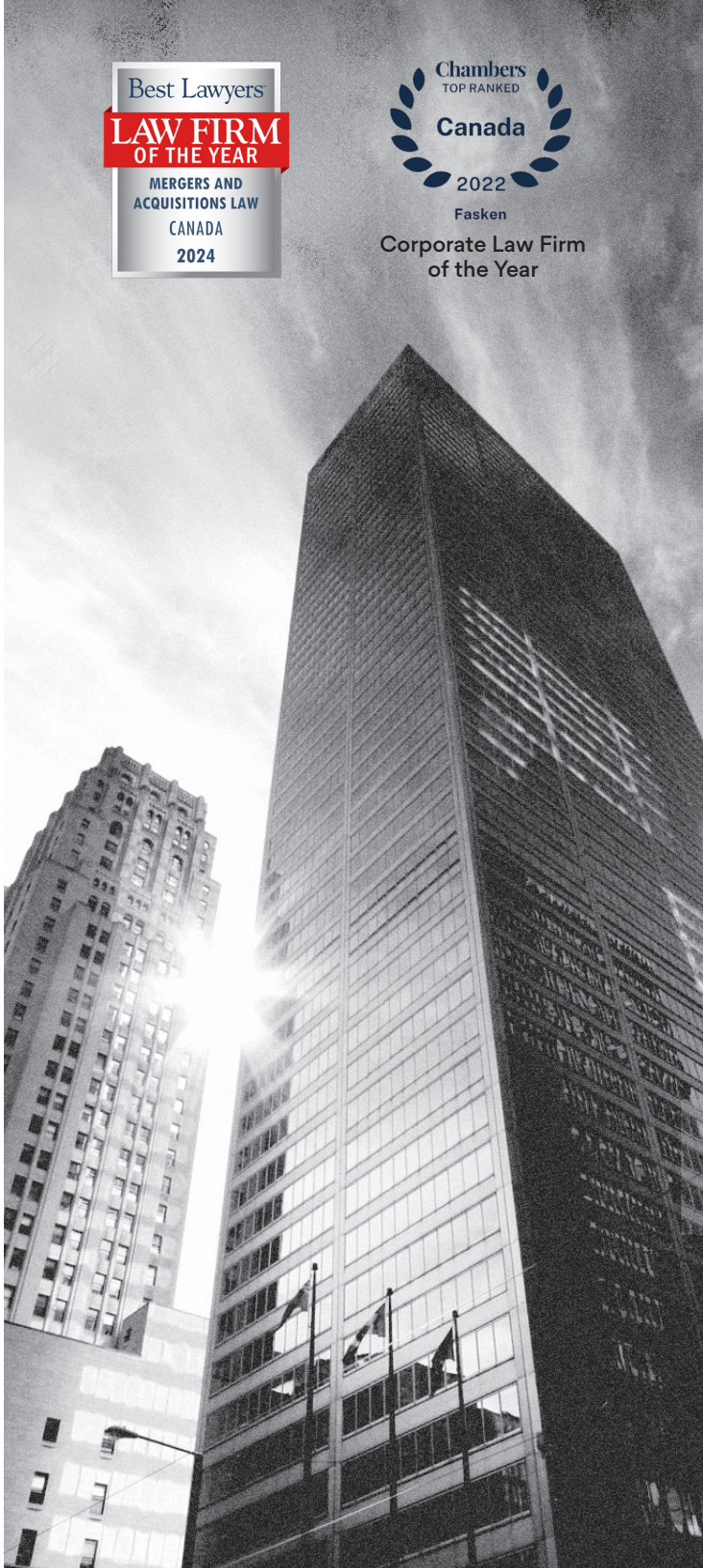
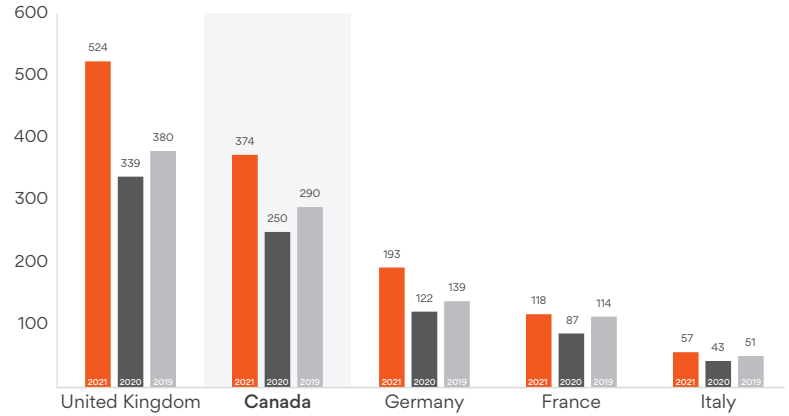


US / Canada Cross-Border M&A Statistics

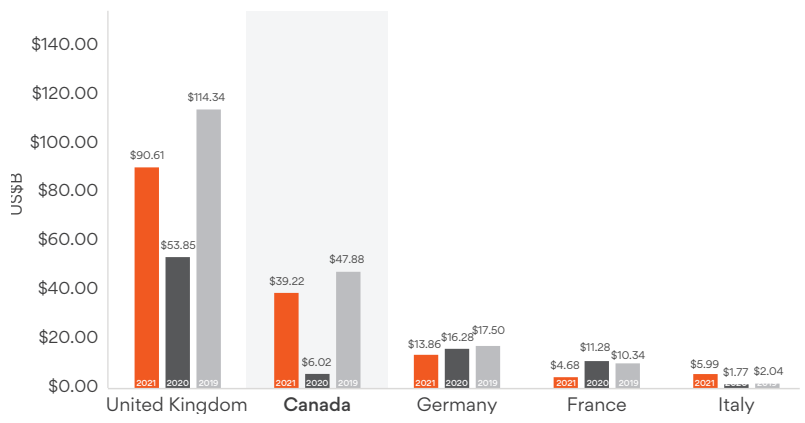
Canada is consistently amongst the most popular destinations for outbound US investment. Indeed, Canada routinely ranks second behind *only* the U.K. in outbound US M&A by deal volume and within the top five destinations for US outbound M&A by deal value. Similarly, Canada is routinely amongst the top three largest sources of US inbound M&A by both deal volume and deal value.

To illustrate, the following graphics represent outbound and inbound US M&A for the years 2019, 2020, and 2021 involving four other of the US' most common trade partners historically, namely the U.K., Germany, France, and Italy. Notably, even though each of these countries has a GDP larger than Canada's, only the U.K. ranks higher than Canada as a destination for US outbound M&A.

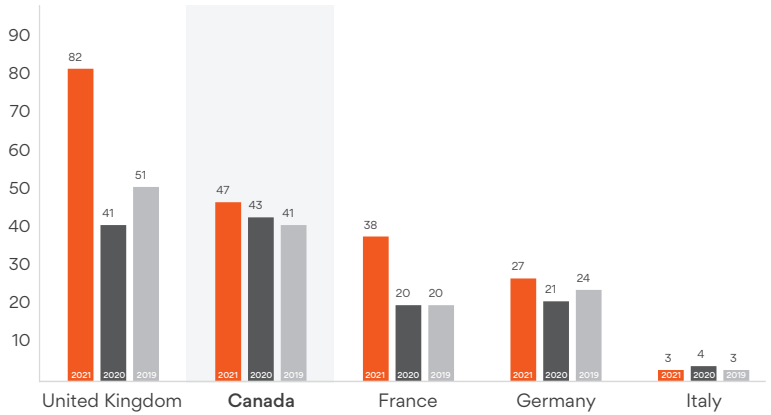
GRAPHIC 1 – US OUTBOUND M&A BY DEAL VOLUME



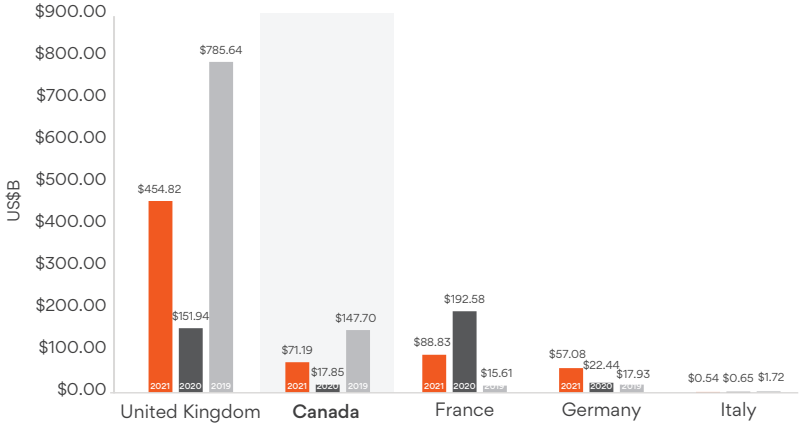
GRAPHIC 2 – US OUTBOUND M&A BY DEAL VALUE



GRAPHIC 3 – US INBOUND M&A BY DEAL VOLUME



GRAPHIC 4 – US INBOUND M&A BY DEAL VALUE



Data courtesy of Pitchbook. Fasken has relied on Pitchbook and has not reviewed for accuracy.

Deal Structure & Tax Considerations

Below follow some of the key transaction structuring considerations for a US buyer acquiring a Canadian target.

Canadian AcquireCo	The typical structure of US inbound M&A into Canada involves the incorporation of a Canadian special purpose corporation (AcquireCo) by the US buyer. Use of an AcquireCo maximizes paid-up capital, which facilitates future cross-border distributions without Canadian withholding tax (by contrast, dividends would result in Canadian withholding tax). Following closing, AcquireCo will "amalgamate" with the target. In circumstances where the inbound transaction involves acquisition financing by AcquireCo, an amalgamation may allow for the deduction of the interest component of debt payments by the amalgamated entity. Specifically, as Canada does not have consolidated tax reporting, the amalgamation is necessary to effectively push down the debt to the target.
Exchangeable Share Structures	Where a US buyer seeks to pay a Canadian resident seller wholly or partly in shares rather than entirely in cash, certain Canadian tax issues may arise. In particular, the sale of shares of a Canadian corporation by a Canadian resident seller in exchange for equity of a non-Canadian entity does not qualify for a tax deferral and may result in Canadian taxes arising from any gain realized by the seller on the sale. A Canadian resident seller's tax liability could prevent the seller from proceeding with a sale to a US buyer where it receives insufficient cash consideration from the buyer to fund this tax liability. Canadian tax law only provides for a tax deferral where a Canadian resident seller receives shares of a Canadian corporation. To facilitate a tax deferral for a Canadian resident seller, a US buyer can arrange for its Canadian subsidiary to pay the seller with shares in its capital stock that are exchangeable, at the option of the seller, into the US buyer's shares. These exchangeable shares are the economic equivalent of the US buyer's shares (i.e., which mirror all rights attaching to the US buyer's shares, including regarding dividends and liquidation entitlements). Because the Canadian resident seller receives shares issued by a Canadian corporation as consideration for the sale of the target shares, the Canadian seller may elect to defer the Canadian tax on all or a portion of the gain arising from the sale until the exchangeable shares are exchanged for those of the US buyer.
Corporate Entities	Unlimited liability corporations (ULCs) are sometimes used in cross-border deals. ULCs differ from limited corporations in that ULC shareholders can be held personally liable for the debts of the company in the event of insolvency. ULCs are treated the same as limited corporations under Canadian federal income tax. However, from a US federal income tax perspective, ULCs can be treated as flow-through entities. ULCs are available under the laws of the provinces of Alberta, British Columbia and Nova Scotia.
Amalgamations, not Mergers	The closest Canadian equivalent to the US concept of merger is an amalgamation. Unlike a merger, where one company "survives" and the other ceases to exist, the amalgamating companies all continue as a single corporate entity with the amalgamated corporation possessing all of the assets, rights and liabilities of each of the amalgamating corporations. To achieve a US-style absorptive merger under Canadian law requires a court-approved plan of arrangement whereby the court decrees that only a single predecessor survives the amalgamation. Amalgamations are often used in US inbound private M&A as discussed above (see "Canadian AcquireCo"). Plans of arrangement are much more common in Canadian public M&A than private M&A.

Deal Terms: Differences in Law on Key Points

Canadian contract law is similar to New York and Delaware law in many respects. That said, there are several differences that may impact M&A negotiations and agreements.

Ordinary Course Covenants

Canadian caselaw on ordinary course covenants is complex and has sent more mixed messages than its Delaware counterpart. Issues to be navigated with caution include the impact of a "consistent with past practice" qualifier, whether the ordinary course will include extraordinary measures in response to extraordinary events, and the impact of a proviso allowing deviation from the ordinary course with the buyer's consent. Unlike in Delaware, Canadian courts have held that ordinary course covenants and MAE clauses should read closely together.

MAE Clauses

Canadian courts have looked to Delaware in interpreting and applying MAE clauses. However, notable differences persist. While Delaware courts have been clear that an MAE analysis is an objective analysis and not a subjective analysis, Canadian courts have been inconsistent on the point. In adition, while Delaware no longer requires an MAE to arise from an "unknown" risk, Canadian courts have not dispensed with this requirement. Finally, while Delaware courts regularly caution that MAE clauses impose a "heavy burden" on the buyer, Canadian courts have given the ambiguous (and somewhat opposite) instruction that MAE clauses are to be "interpreted from the buyer's perspective".

Sandbagging

States such as Delaware are understood to be receptive to sandbagging such that they will enforce a pro-sandbagging clause and allow a buyer to claim on a breached seller representation and warranty even where the buyer had knowledge of the inaccuracy prior to execution. Caselaw on sandbagging in Canada is very thin with the few courts that have considered the issue having sent conflicting signals. Moreover, these decisions predate significant developments in Canadian law imposing duties of good faith and honest performance in contractual relations. Buyers can negotiate for a pro-sandbagging clause but it may be of limited value. Sellers can negotiate for an anti-sandbagging clause but it may be redundant. Common market practice in Canada is to remain silent on the issue.

Specific Performance

Specific performance is generally characterized as an exceptional remedy under Canadian law with Canadian courts often reluctant to award it, even in the face of an express specific performance clause. Regardless of what M&A counterparties have contractually agreed, specific performance remains an equitable remedy at the discretion of the court. While the same is generally the case in the US, courts in certain states such as Delaware often exhibit a greater respect for the freedom of contract and deference to contractually agreed remedies than do their Canadian counterparts.

Antitrust (Competition)

Antitrust

As of 2023, subject to certain exceptions, acquisitions of Canadian companies that exceed the "party-size" threshold and "transaction-size" threshold are subject to pre-merger notification. Asset values are calculated having regard to the book value of the assets in Canada rather than the fair market value of the assets in Canada.

For the party-size threshold, the parties to the transaction, together with their affiliates, must have assets in Canada or annual gross revenues from sales in, from or into Canada exceeding C$400 million. For the transaction-size threshold, the value of assets in Canada of the target, or the gross revenues from sales in or from Canada generated by those assets, must exceed C$93 million. The foregoing dollar amounts are subject to annual adjustment.

If each of the applicable thresholds is exceeded, the merging parties are required to provide prescribed information to the Competition Bureau (the "Bureau") and they cannot complete the transaction until the statutory waiting period under the *Competition Act* has expired or has been terminated or waived by the Commissioner of Competition (the "Commissioner"). The statutory waiting period expires 30 days after all prescribed information has been provided to the Bureau unless, prior to the end of this initial 30-day period, the Commissioner issues a Supplementary Information Request (which is the equivalent of a Second Request in the US).

If a Supplementary Information Request is issued, the statutory waiting period expires 30 days after the merging parties have complied with the Supplementary Information Request. In our experience, it generally takes a few weeks to several months for the merging parties to respond to a Supplementary Information Request, depending on the nature and scope of the information requested by the Bureau.

Substantive Merger Review

All mergers, regardless of whether they are subject to pre-merger notification, may be subject to substantive review under the *Competition Act*. In this regard, the term "merger" is defined broadly to mean "the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, customer or other person".

The Commissioner reviews mergers in order to determine whether they result in, or are likely to result in, a substantial prevention or lessening of competition. As part of this analysis, the Commissioner considers a number of factors, and the Commissioner's approach is detailed in the Bureau's *Merger Enforcement Guidelines*. The length of the Commissioner's review varies depending on whether a merger is designated as "non-complex" or "complex". While the review of "non-complex" mergers typically takes no more than 14 days, the review of complex mergers can, in certain cases, exceed 150 days (such as when a Supplementary Information Request has been issued).

If the Commissioner concludes that a merger results in, or is likely to result in, a substantial prevention or lessening of competition, she or he will normally attempt to resolve her or his concerns with the parties. If a resolution cannot be reached with the parties, the Commissioner can apply to the Competition Tribunal (the "Tribunal") for an order.

Foreign Investment

Acquisitions of control of existing Canadian businesses by US buyers are either reviewable or notifiable under the *Investment Canada Act*. Whether an investment is reviewable or notifiable depends on several factors, including the structure of the transaction and the nature and value of the assets or business being acquired.

Pre-Closing Review Thresholds

As of 2023, the direct acquisition of control of a Canadian non-cultural business by a US buyer is subject to pre-closing review where the target has an enterprise value of C$1.931 billion or greater. The direct acquisition of control of a Canadian cultural business (such as a business engaged in the publication, distribution or sale of books, magazines, periodicals or newspapers) by a US buyer is subject to pre-closing review where the book value of the Canadian business' assets is at least C$5 million. Indirect acquisitions (e.g., acquisitions of a foreign corporation that has a Canadian subsidiary corporation carrying on the Canadian business) of control of a Canadian non-cultural business by a US buyer are not subject to review, regardless of size.

Net Benefit Test

A transaction that is subject to pre-closing review cannot be completed unless the Canadian government is satisfied that the investment is likely to be of "net benefit to Canada". The government's net benefit analysis takes into account a number of factors, including the effect of the investment on the level and nature of economic activity in Canada; the degree and significance of participation by Canadians in the Canadian business; and the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada. In terms of timing, the *Investment Canada Act* provides the government with an initial period of 45 days to complete the "net benefit" review. If more time is required, the government can unilaterally extend this period for up to 30 days. Further extensions are possible only with the consent of the investor.

National Security Review

The *Investment Canada Act* includes provisions allowing for the review of investments by non-Canadians that "could be injurious to national security". Significantly, in contrast to the "net benefit" review discussed above, both controlling and minority investments are potentially subject to national security review in Canada. If a national security review is ordered, the government must notify the investor and the investment cannot be completed while the review is ongoing. If the investment has already been completed, a review can still be ordered following closing. The expression "national security" is not defined in the *Investment Canada Act*. However, annual administrative reports released by the government provide helpful guidance.

Employment & Severance

In an overall comparison between Canadian and US laws governing labour and employment, there is a considerable degree of similarity. One major difference between the two countries, however, is that there is no "employment at will" doctrine in Canada. Instead, in Canada the employment relationship may legally be terminated in one of two typical ways: for cause or without cause.

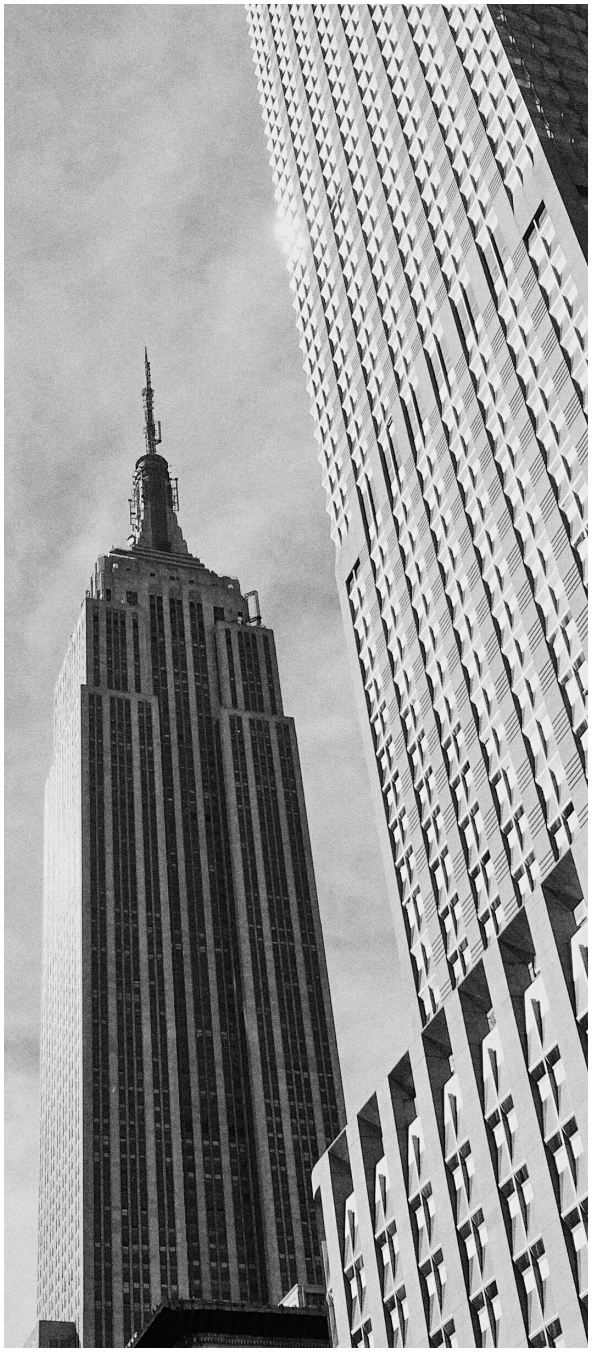
Where there is cause, there is no obligation on the employer to provide advance notice to the employee or payment in lieu thereof. Cause for termination can include incompetence, insubordination, conflict of interest, theft or material dishonesty, and other judicially recognized misconduct that warrants discharge. However, the threshold for cause is high. Without cause, an employer must provide reasonable notice or pay in lieu of reasonable notice. However, the right to terminate the contract of employment in the absence of just cause by providing the appropriate notice of termination or payment in lieu is limited in certain Canadian jurisdictions.

Termination without cause occurs where an employee is terminated from employment not necessarily because the employee has done something terribly wrong, but rather because the employer, for whatever reason, has decided that the employee's services are no longer required. This includes a redundancy or reorganization scenario.

As indicated above, for termination without cause, employers in all Canadian jurisdictions are required to provide advance notice of termination or layoff, or to offer compensation in lieu of notice. The applicable employment standards legislation mandates the minimum notice period and provides a "sliding scale" of notice depending on the seniority of the employee, which typically peaks at 8 weeks' notice. These termination notice periods are simply the statutory minimum periods of notice required. Some Canadian jurisdictions also have a minimum statutory severance pay entitlement that varies depending on the seniority of the employee.

In addition to the minimums set by statute, and absent a binding employment contract setting out termination entitlements, employers in Canada are generally required to provide reasonable notice under both common law and civil law, as applicable. In the event of dispute, courts may be called upon to determine how much notice an employee is entitled to receive. Although there is no formula for determining the reasonable period of notice, judicial awards tend to approximate one or more months per year of service to a typical maximum of 24 months.

Advance notice of "group layoff" or "mass termination" (generally 50 or more terminated employees) obligations are required in most Canadian jurisdictions.



Litigation & Governing Law

The Canadian litigation landscape is more similar than dissimilar to that in the United States. As relates to M&A, some noteworthy points include the following.

Litigation Generally

Canada is generally a less litigious environment than the US, including in connection with M&A. This is likely at least in part explained by Canada's "loser pays" system whereby the successful party is often awarded a portion of their costs. Another explanation may be that damages awards are perceived to be lower in Canada than south of the border. Punitive damages are also very rare in Canada, requiring egregious facts and even then typically only giving rise to modest punitive damages amounts. Finally, jury trials are very rare in Canada outside specific types of claims such as personal injury or libel.

Governing Law

Unlike in the US where non-Delaware parties often agree to have their transaction governed by Delaware law, Canadian transactions are typically governed by the law of the province (or territory) with the closest nexus to the seller. Similarly, it is very rare for a Canadian seller to agree to have Delaware law govern or to attorn to the jurisdiction of US courts. Arbitration clauses in M&A are becoming somewhat more common, but remain in the minority. Sometimes a bifurcated approach is adopted, e.g., where pre-closing disputes are submitted to the courts while post closing claims (e.g. for indemnification or in relation to an earn-out) are submitted to confidential arbitration.

"Four Corners" vs "Factual Matrix"

Should an M&A transaction be litigated, an important difference between US and Canadian law is the difference between the "four corners" and the "factual matrix". Specifically, whereas Delaware courts adhere to the "four corners" principle whereby they generally seek to resolve contractual interpretation disputes, to the extent possible, without looking beyond the wording of the agreement, Canadian courts adhere to the "factual matrix" principle whereby overall context will generally be taken into account in every contractual interpretation dispute.

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Fasken is a full-service law firm with over 925 lawyers in all major Canadian business centers and deep bench strength in cross-border M&A, private equity, capital markets and litigation.

As industry leaders, we are informed by deep experience and expertise. Moreover, with more than 100 dedicated M&A practitioners, we respond quickly and effectively to any public or private M&A transaction regardless of the industry, timing, size, scope, or complexity.

We frequently lead Canada's most noteworthy transactions and complex cross-border deals including negotiated acquisitions and divestivities, joint ventures, strategic alliances and contested corporate transactions. We are also at home acting as local counsel assisting US law firms to ensure that deals are done seamlessly, in real time and with the highest levels of service.

Fasken Awards & Rankings

A clear leader in Canadian M&A

		FASKEN	Stikeman Elliott	Blake, Cassels & Graydon	Osler, Hoskin & Harcourt	McCarthy Tétrault	Davies Ward Phillips & Vineberg	Torys
Mergermarket	Canadian M&A (by deal count)	**No. 1**	No. 3	No. 7	No. 2	No. 4	No. 6	No. 10
Bloomberg	M&A – Canada Announced (by deal count)	**No. 1**	No. 6	No. 8	No. 2	No. 4	No. 5	No. 7
	M&A – Canada Mid-Market (up to US$500 million, by deal count)	**No. 1**	No. 6	No. 8	No. 2	No. 4	No. 5	No. 7
	M&A – Canada Mid-Market (up to US$250 million, by deal count)	**No. 1**	No. 6	No. 13	No. 2	No. 4	No. 5	No. 7
REFINITIV	Canadian Involvement Announced (based on number of deals)	**No. 1**	No. 4	No. 6	No. 2	No. 5	No. 7	No. 13
	Canadian Involvement Completed (based on number of deals)	**No. 1**	No. 4	No. 7	No. 2	No. 6	No. 5	No. 8
	Canadian Involvement Mid-Market	**No. 1**	No. 4	No. 7	No. 2	No. 5	No. 6	No. 13
	Canadian Involvement Small-Cap	**No. 1**	No. 4	No. 11	No. 2	No. 5	No. 9	No. 16

* Mergermarket (Q2 2023), Bloomberg (Q2 2023), Refinitiv M&A (Q2 2023), Refinitiv Mid-Market/Small-Cap (Q2 2023)

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"They are a great team to work with, offer great client service, and are very responsive and efficient. Fasken goes above and beyond. They always impress."

- Client Quote, Chambers Global

"The entire Fasken team is not only knowledgeable of all the relevant laws, but they are true partners and help management think through critical business matters in a practical way, allowing management to make sound business decisions. Compared to others, I think Fasken went above and beyond, I was very impressed."

- Client Quote, Chambers Global

"My firm engaged Fasken to assist us in connection with our private equity client's acquisition. Our client and the entire deal team were very impressed with the work of the Fasken team. I frequently work with, and across from, top firms as part of my private equity practice and the Fasken team was more responsive, more technically proficient and much easier to deal with."

- International Law Firm that engaged Fasken for cross-border deals

"The Fasken team are very complementary, and their expertise in their respective fields is second to none."

- Client Quote, Chambers Global

"Of the many other firms that I have encountered... I have not seen their equal in Canada."

- Client Quote, Chambers Global

"Excellent service, very timely responses, and a wide array of experience in several different types of industries. I am comfortable entrusting matters in their hands. They get the job done and are good at it."

- Client Quote, The Legal 500

"Our company was undergoing a cross-border transaction, which was quite complex and required in-depth business considerations, regulatory advice, and Federal Commission interaction. The depth of knowledge and experience the Fasken attorneys brought to the table was astounding."

- International Law Firm that engaged Fasken for cross-border deals

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